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Opening Statement of Chairman Jon Porter

Hearing of the House Government Reform
Subcommittee on Federal Workforce and Agency Organization

“Adding a Real Estate Investment Trust (REIT) Index Option to the Thrift Savings Plan: Considering the Views and Advisory Role of the Employee Thrift Advisory Council (ETAC)”

April 26, 2006

Mark Twain once said, “Put all your eggs in the one basket and - WATCH THAT BASKET.” The point is that such a maneuver is risky and unwise and if you are going to do something that foolish you better keep your eyes on the basket at all times. Unfortunately, the current makeup of the Thrift Savings Plan does not provide Federal employees with the ability to diversify their funds for retirement. Between 2000 and 2003, the highest average annual rate of return on any stock in the fund in the Thrift Savings Plan was -.1%, the rate of return on REITs was near +20%. During that time period, there was no room for diversification and Federal employees throughout the government lost their hard earned money. The fact that REITs have had an historically low correlation of returns to the returns from other TSP funds is important to protect an investor from market volatility. This was emphasized by a senior analyst for Morningstar in a Washington Post article in January, in which the analyst was quoted as saying: “Real estate stocks do not move in lockstep with the rest of the market, and that makes them good portfolio diversifiers.”

Yale University Endowment Chief Investment Officer David Swensen urges a real estate allocation of 20% for investors, which could be accomplished through investment in REIT stocks. This is a complete impossibility in the Thrift Savings Plan. While REITs and real estate have performed well in recent years, the performance of REITs and real estate over the longer term is what makes the case and is the reason why well established retirement savings plans have routinely made a significant allocation to commercial real estate investment. For the past 30 years, REITs have outperformed the Dow Jones Industrials, the NASDAQ Composite, and the S & P 500. IBM, the sponsor of the largest private sector 401(k) plan in the country, offers a distinct REIT option for plan participants and told the Subcommittee last year that “we are committed to REITs as a core asset class for defined contribution plans . . . Their return, volatility, diversification, dividend yield, and taxation characteristics make the case.” IBM is not alone. Many large corporations offer distinct REIT options in their 401(k) plans, including General Motors, Verizon, and Ford Motor Company.

Congressional consideration of the addition of options to the Thrift Savings Plan is by no means unprecedented. After sufficient Congressional consideration, Congress established the first three funds to the Thrift Savings Plan when it created the board. In anticipation of the need for more funds once the Board got up and running, the *Joint Explanatory Statement of the Committee of the Conference* stated, “Should additional investment vehicles become desirable, Congress can authorize them.” When crafting the enabling legislation for the Thrift Savings Plan, according to the Conference Statement, Congress expressed concern about political manipulation by the Board members – the kind of manipulation and lobbying that the Board has been engaging in over the past several months. That is why Congress set up the structure of the funds to be passively managed by the Board, as opposed to being actively managed. The only reference to Congressional political manipulation in the Conference Statement was a concern about the possibility of some sort of “raid” on the trust fund by Congress during budget cuts, not about Congress selecting new index funds.

H.R. 1578 is simply about providing choice to Federal employees and giving them the opportunity to diversify their portfolio. It is nothing more. It is Congress’ responsibility as ultimate fiduciaries of the TSP to bring these opportunities within reach of every employee. Adding options to the Thrift Savings Plan in an effort to enable proper diversification has been a priority of the Subcommittee for the past couple of years. In July 21, 2004, then-Subcommittee Chairman Jo Ann Davis sent a letter to the Executive Director of the Federal Retirement Thrift Investment Board Gary Amelio requesting advice on potentially adding a REIT index option to the Thrift Savings Plan. Amelio responded by briefing Subcommittee staff the next month. At that briefing, Amelio expressed concern with the addition of a REIT index fund to the Thrift Savings Plan at that time mostly because of the Board’s focus on rolling out lifecycle funds. He did state, however, that if he were called upon to add another option to a retirement plan with the same funds as those in the TSP, the first thing he would add would be a REIT Index Fund option.

After several months of correspondence between the Board, the Subcommittee, and outside experts, the Board maintained their opposition to the addition of a REITs index fund since, according to the Board in January of last year, the “funds currently offered by the TSP are sufficient for the construction of risk-optimized portfolios appropriate for TSP participants.” This statement is clearly untrue. Simply ask some of the participants in the TSP, including some of my colleagues up here on the dais who probably lost a lot of money in the TSP between 2000 and 2003 because there was no opportunity to sufficiently diversify their portfolio.

The problem is that the TSP managers are not asking plan participants for their opinion. According to a 2005 GAO report, “TSP managers said that they have not surveyed participants since the early 1990’s ” and GAO found that “because TSP relies on customer complaints as an indicator of participant satisfaction, its managers do not have the information necessary to determine the degree to which participants are satisfied with the services.” GAO further found that the “TSP managers’ reliance on complaints does not take into account participants who are dissatisfied and have not complained or do not know where to complain[.]” Participants are left with the burdensome task of sending letters to the TSP managers themselves or the call center. This GAO finding belies Executive Director Amelio’s claims at last year’s hearing that he gets a great deal of feedback based on letters he received when the TSP suffered a significant record keeping problem.

GAO also found that the Employee Thrift Advisory Council is equally unhelpful in assisting the TSP managers in understanding the needs and wants of plan participants. GAO found that “while some ETAC representatives provide TSP managers with feedback on draft TSP publications, legislative initiatives, and other issues, ETAC representatives do not systematically solicit feedback from their constituents. Some ETAC representatives may receive sporadic feedback from participants, but ETAC does not conduct surveys of plan participants.” GAO concluded, therefore, that “the extent to which participants within the represented agencies and employee organizations provide feedback to the ETAC representative is unclear.”

This ambiguity was demonstrated this past month when ETAC voted on a resolution opposing the addition of a REIT index fund at the present time. According to a letter to the Subcommittee from the Senior Executives Association, one of the ETAC members that the SEA appointed to the Council at an ETAC meeting took a position not held by the SEA itself. Thus, not only did that member not survey any members of the SEA, it took a position antithetical to SEA policy. A further indication that ETAC was not acting in a full representative fashion when it considered the resolution on the addition of a REIT index fund was demonstrated when the Board’s Executive Director Gary Amelio, who is not an ETAC member, recommended language to the Council that was ultimately adopted stating that the “development of a new fund must come from an independent process developed by the Plan’s fiduciaries.” I mention the problems with ETAC not to criticize the employee groups, who are doing what they can with a broken process and who are forced to take action and make recommendations without the benefit of good tools for gathering important information from the Federal employees they serve. I do join GAO with the criticism of ETAC being the primary tool to get supposed employee feedback. It simply can’t do the job.

In its recommendations for executive action, GAO proposed that the Federal Retirement Thrift Investment Board direct the Executive Director to “(1) develop a systematic effort to assess TSP participants’ overall satisfaction with the services provided and (2) institutionalize the routine collection of information and systematic assessment of industry trends and innovations.” According to GAO, “the Board disagreed with our recommendation regarding the implementation of an evaluation effort to assess the level of customer satisfaction. . . . As we state in our report, the private sector plan managers that we spoke with believe that direct, ongoing participant feedback is needed to respond to the changing needs of plan participants. Without obtaining more frequent feedback from participants, TSP managers cannot determine what improvement would best satisfy participants’ needs.” Understanding what a Federal employee really wants in the Thrift Savings Plan is clearly an issue with the Plan’s managers.

After hearing the Board’s concerns and discussing the bill with outside experts I, along with Representative Chris Van Hollen and full committee Chairman Tom Davis, introduced H.R. 1578, a bill that now has 169 co-sponsors, ranging from House Minority Leader Nancy Pelosi to House Majority Leader John Boehner. This is not a partisan bill, but rather a bi-partisan effort that boasts 71 Democrats and 98 Republican cosponsors, all of whom want to provide Federal employees with the opportunity to further diversify their portfolios. A week after introduction, the Subcommittee held a broad-based hearing on the merits of adding a REITS index fund as an option to the TSP.

At that hearing over a year ago, Executive Director Amelio told the Subcommittee that “the Board members and I have decided to engage a reputable investment consulting firm to

assist in analyzing various investment-related plan issues,” including REITS, and he specifically requested that “any consideration of legislation be delayed at least until after the appropriate review by the plan’s fiduciaries.” However, the Board took no effort at that time to act on its promise to the Subcommittee. A month after the hearing, in response to the Subcommittee’s question for the record with regard to when the study of all possible additions to the TSP would be made available, the Board made no time commitment and indicated that it would study the options on its own timetable. In July, both the Senate and the House sent separate letters to the Board requesting a written report on additional investment options to the TSP by January 1, 2006. The House letter emphasized the importance of a timely report so that it could act on the Board’s recommendations this Congress. The Board responded to the letters in August stating that it expected to select an investment consultant by September 2005. Although the Board expressed no intention on meeting the Senate and House deadline of January 2006, it did not indicate that the study would be completed after Congress adjourned *sine die*.

In January, the TSP Board’s staff told Government Reform Committee staff that it had contracted with Ennis Knupp and Associates to conduct a four-part evaluation of the TSP and, notwithstanding repeated Congressional requests that the study of additional options be completed with sufficient time to consider legislation in the 109th Congress, the TSP staff revealed that such study would be the fourth and final part of the contract and would probably not be completed until after Congress adjourned *sine die* and possibly not until 2007. A March 2006 *Government Executive* article correctly characterized the Board’s action: “TSP administrators already have voiced their discontent with the addition of a REIT fund, and have stalled its progress by hiring an outside consultant who will review a range of possible funds by the end of 2006.” At an April Board member meeting, Board Member Thomas Fink even recognized that the decision to call in a consultant to review existing TSP funds and investment policy probably created a perception on Capitol Hill that the board is stalling on legislation in hopes that the REIT proposal will fade.

The Board’s unresponsiveness and stall tactics to delay the study of investment options to the Thrift Savings Plan can no longer be tolerated. We cannot have another period, like we did between 2000 and 2003, where Federal employees lost thousands of dollars. As the Federal government seeks to modernize its recruitment and retention tools to keep pace with the private sector, additional investment options are important in accomplishing this goal. According to the Board’s own figures, the percentage of private companies offering five or less options, like the TSP, dropped from 7% to 1% from 1999 to 2003. Conversely, the average number of investment options available today in all private sector 401(k) plans is 18 and is 20 for private sector 401(k) participants with 5,000 or more participants. As the number of investment options rises, employees can diversify their assets and protect their investments from dramatic volatility in the market.

This Subcommittee has been studying the addition of a REIT index fund option for almost two years, including holding two Congressional hearings and engaging in numerous discussions and correspondence with the Board and outside experts. Although it could have been helpful to have had an additional study conducted by the Board’s consultant, the Board does not see the TSP’s lack of diversification as a problem and has, therefore, not responded to Congress’ expressed desire to expand options this Congress. Nonetheless, the Subcommittee’s study of the addition of a REIT index fund to the TSP reveals that it is the next best option to the

Thrift Savings Plan and would provide significant diversification benefits. Burton Malkiel, a professor of economics at Princeton University, was recently quoted in Government Executive as stating that “The Federal Thrift Savings Plan serves as an excellent model for well-designed retirement plans . . . it could be improved, however, by including an additional class in the mix of funds – real estate investment trusts.” I, and at least 169 other Congressional members, agree.

I thank our witnesses for being here, and I look forward to the discussion.

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